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## INTEREST-FREE LOANS AS A METHOD OF STIMULATING PRIVATE RENTAL HOUSING CONSTRUCTION

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### Introduction

In the November 1981 budget speech, the federal government announced that in order to stimulate construction of rental housing, interest-free loans would be provided to private investors for up to 15,000 units. These units are to be allocated in tight rental markets. In March, 1982, the allocation was increased to 30,000 units.

The amount of the interest-free loan was first set at \$7,500 per unit. The government has since announced that it will consider proposals requiring a larger loan "where it can clearly be demonstrated that the cashflow deficit for a project during its initial years of operation would be prohibitive even when considering longer term prospects for project viability".

Is this an efficient and effective method of using public funds in order to stimulate construction of rental units? Are the subsidies under the program targeted at those who need assistance the most?

To begin to answer these questions, CHF has undertaken a detailed analysis of the Ontario Rental Construction Loan Program (ORCL). This program is very similar to the recently announced federal one (see Table 1 for a comparison). It was implemented during 1981 as a one-year program. It is possible, therefore, to draw some conclusions about ORCL. These conclusions are relevant to an assessment of the potential impacts of the Canada Rental Supply Program (CRSP).

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### Supply of Rental Housing

- o Both ORCL and CRSP will add to the supply of rental housing if the subsidies are deep enough. As of April, 1982, 16,715 construction starts under ORCL have been approved.

### Level of Subsidies

- o ORCL provides an interest-free loan of \$6,000 per unit for 25 years. This is equivalent to a cash grant of \$4,529 per unit, which equals about 5.6% of the capital cost of a project. (City of Toronto (1982) Housing Subsidies to Private Developers.)

... / 2



- o In addition to the interest-free loans, federal tax incentives also apply. The Canadian Institute of Public Real Estate Companies estimates the value of federal tax incentives to be worth 25% to 30% of project cost (capital cost allowance deduction accounts for 8-10%; soft costs deductability account for 12-14% and interest expense provisions 5-6%). (CIPREC (1982) Shortage of Rental Housing.)
- o ORCL (but not CRSP) allows investors to stack ORCL subsidies with MURB subsidies. Based on 1981 cost estimates from several projects, the City of Toronto determined that the total ORCL subsidy, including federal tax incentives, is equivalent to a per unit grant of \$30,669. This compares to a \$31,438 per unit grant for a non-profit project, a difference of \$769 (2.5% per unit). (City of Toronto (1982) Housing Subsidies to Private Developers.)

### **Location of Rental Units**

- o As with CRSP, it was promised that ORCL units would be provided in tight rental markets. About 8,000 units were promised for Metro Toronto and a large percentage was promised for tight markets in such cities as Toronto, Hamilton and Oshawa.
- o ORCL has failed to locate rental units in most of the tighter markets:
  - 0.2% of ORCL units to be built in Toronto
  - 8.0% in Metro Toronto
  - 0.1% in Hamilton
  - 1.3% in Oshawa

### **Affordability**

- o Except in the initial year, there is no mechanism in the ORCL program to control rent levels.
- o CMHC's maximum unit prices were imposed so as to guarantee construction of modest quality housing. This is an inadequate affordability control mechanism unless there is a competitive rental market.
- o There is no way of ensuring that primarily low and moderate income households benefit from the tremendous levels of public subsidies provided ORCL investors.

### **Rent Supplement Tenants**

- o Both ORCL and CRSP have inadequate mechanisms respecting the number of units which must be allocated to low-income households.
- o ORCL required owners to offer up to 20% of their units to local housing authorities for rent supplement tenants. As of April, 1982, however, only 6.3% of ORCL units have been allocated to rent supplement households.

### **Targetting: Who Benefits From the Subsidies?**

- o ORCL and CRSP interest-free loans directly benefit the owners of and investors in rental accommodation. With no effective control on long-term rent levels, it is

unlikely that much, if any of the subsidy, will filter down to the tenants. There is no control over how many, if any, tenants will be low and moderate income households.

- o ORCL stacked with MURB means that the higher the tax bracket of the investor, the greater the subsidy.
- o The total subsidy available to ORCL investors through the interest-free loans and the federal tax incentives can represent roughly 30 to 35% of the capital cost of the project. Public subsidies are, therefore, paying for about 1/3 of the cost of a private capital investment with very few strings attached.

### Summary

- o ORCL and CRSP assist in stimulating construction of new rental units.
- o Aside from increasing supply, this type of program has few broader social impacts. The financial benefits accrue to those who least need them.
- o The federal non-profit housing programs not only create additional supply but also have a long-term positive social impact.
- o Units built under the non-profit housing programs:
  - are targeted to low and moderate income households;
  - do not create private capital investments at public expense;
  - have a positive long-term impact on affordability;
  - can be allocated and built in municipalities where the need is the greatest;
  - provide a high percentage of units to rent supplement households; and
  - cost the taxpayer less in the long-term.
- o In the federal non-profit housing program, the subsidy remains permanently in the public domain as a permanent contribution to a non-inflationary form of rental housing stock for the country.
- o Private sector subsidy programs, such as ORCL and CRSP, are short-term supply programs and only the owners/investors benefit in the long run.

**TABLE I**  
**A Comparison of the**  
**Ontario Rental Construction Loan Program (ORCL)**  
**and the**  
**Canada Rental Supply Plan (CRSP)**  
**(revised ORCL program data in parentheses)**

Program Characteristic	ORCL	CRSP
Assistance mechanism	Interest-free loan secured by 2nd Mortgage	Interest-free loan secured by 2nd Mortgage
Mortgage Term	25 years	15 years
Repayment Period Begins	11th year of agreement (16th year of agreement)	15th anniversary of the interest adjustment date of the 1st mortgage
Length of Repayment Period	15 years (10 years)	Must not exceed remaining amortiza- tion period of 1st mortgage
Maximum Assistance Level	\$4,200 per unit (\$6,000 per unit)	\$7,500 per unit suggested but no maximum established
Supply Target of Program	10,000 units (15,000 units)	30,000 units
Assisted Housing Requirement (under Rent Supplement Program)	15% of units (20% of units)	33% of units
Units for the Disabled	Special units "should" be made available, but not required	5% of units must be designated for disabled.